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SUBJECT: New Bundesbank President calms situation;
ethics moves to the fore

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Ref: (A) Berlin 1385 (B) Berlin 1416

1. (SBU) Summary: Well-respected monetary policy expert Axel Weber was appointed as the new Bundesbank President. A supporter of stability-oriented monetary policy, his nomination was well-received across party-lines and among academics as well as in the financial markets. While many observers had feared that the federal government would take advantage of the opportunity provided by Welteke's resignation to increase its influence on the Bundesbank, these concerns were alleviated by the nomination of Weber. Meanwhile, the Welteke case appears to have increased German public sensitivity with regard to ethical conduct. End summary.

Axel Weber Appointed as Bundesbank President

2. (SBU) On April 30, Axel Weber was formally appointed as the new Bundesbank President by President Rau. On April 27, the Bundesbank board approved his nomination by the federal government.

3. (SBU) Former Bundesbank President Ernst Welteke stepped down after the media exposed details about his (and his family's) four-day stay at a luxury hotel in Berlin paid for by Dresdner Bank. Subsequently, Frankfurt public prosecutors launched an investigation to assess whether Bundesbank President Ernst Welteke "accepted an advantage" or Dresdner Bank intended to gain one. The investigation is still underway. Initially reluctant to resign, Welteke stubbornly rejected criticism but eventually conceded when new accusations appeared in the media about a stay at a Formula 1 race in Monaco at the invitation of BMW. The carmaker also owns a bank, which is supervised by the Bundesbank.

Axel Who?

4. (SBU) Although largely unknown to the wider public, Weber is a well-respected academic, whose main research area is monetary policy. He teaches economics at the University of Cologne and is a member of the Council of Economic Advisers to the federal government. From 1998 to 2002, he was director of the Frankfurt-based Center for Financial Studies, which has close ties with both central banks - including the ECB - and private financial institutions. Reportedly, Weber is a confidant of ECB chief economist Otmar Issing.

5. (SBU) Since October 2000, Weber has been a member of the Academic Advisory Council to the Bundesbank. He was Visiting Fellow at the Brookings Institutions in 1992/93, and before that at the Center of Economic Research of the University of Tilburg and at the Queen Mary College of the University of London. He is also a Research Fellow of the Center for Economic Policy Research (CEPR).

Where does he stand?

6. (SBU) Weber is politically independent and has described himself as a "partisan of stability-oriented monetary policy".

17. (SBU) At the press conference following his nomination, Weber stated that the Council of Economic Advisers' assessment of the current interest rate level last fall is still correct. The Advisers found that the key interest rate was adequate given the exchange rate environment. More generally, Weber argued that monetary policy makers should not look dogmatically at only a few variables when trying to control inflation. He stated that a range of variables, not only money supply, needs to be taken into account. He pointed out that the ECB strategy was developed for the transition to EMU, without practical experience on how the transmission mechanism would work. Although the ECB reviewed this last year, Weber considers the process to be incomplete at this point.

18. (SBU) In their 2003 report, the Council of Economic Advisers - led by monetary policy expert Weber - welcomed in principle the review of the ECB's strategy, but qualified their approval by noting that the full integration of the two pillars ("economic" and "monetary" analysis) would have been advisable. The Council also stated that a more precise numerical definition of the inflation target would have enhanced transparency. More generally, it criticized that the methods used to collate all the information relevant for decision-making are not sufficiently transparent and understandable. The report called for the ECB to further strengthen the role of its inflation and economic forecasts both in its decision-making and its communication.

19. (SBU) Observers call Weber "pragmatic and undogmatic", fully in line with the "neo-classical mainstream". He is against using monetary policy for anti-cyclical fine-tuning, but is well aware that interest rate policies have an impact on the real economy. Weber has stated in the past that the low growth in Germany cannot be overcome by short-term impulses, but that there is a need for structural reforms. This assessment is in line with the Bundesbank position.

110. (SBU) When asked at the press conference whether he considers the current exchange rate system as appropriate, he answered that he finds this question "somewhat weird" and that exchange rates are the result of market processes.

111. (SBU) Moreover, Weber stressed that the Stability Pact is still an important pillar of fiscal policy and must not be damaged. He called for a fast reduction of deficits in order to restore the credibility of fiscal policies. He is skeptical of proposals by some Social Democrats to introduce exchange rate targets or a Tobin-tax.

112. (SBU) Weber also said at the press conference that the internal structural reforms launched by the Bundesbank are "absolutely right". He suggested that it put more emphasis on its competence in financial market issues and lead the way in that area within the euro zone in the future. Observers expect him to strengthen monetary and financial research within the Bundesbank in order to bolster his positions in the ECB Council.

113. (SBU) Bert Rrup, also a member of the Council of Economic Advisers, characterized Weber as an advocate of rules-based monetary policy. Rrup would not call him an "extreme hawk", but sees him in the Bundesbank's tradition of strict adherence to stability. Overall, Rrup considers Weber to be an "excellent macro-economist, laying particular emphasis on empirical work and with profound knowledge of monetary policy institutions".

114. (SBU) Weber is not known as an extrovert. Even in his capacity as member of the Council of Economic Advisers, some of whom keep a high media profile, he has hardly ever spoken out. His students at the University of Cologne characterize his lectures as "dry" yet "demanding".

Reactions

115. (SBU) The nomination of Weber was well received across party lines. The opposition CDU, CSU and FDP all welcomed the government's decision, stressing that it is in the interest of the Bundesbank's independence. Both academic and financial market circles reacted positively.

¶16. (SBU) Some observers, however, regard his lack of practical central banking experience as a weakness. Moreover, they claim that he has no experience in managing and restructuring a large institution.

¶17. (SBU) Others criticize that the natural and best-qualified candidate for Bundesbank President would have been Vice-President Jrgen Stark, who was not favored by the government as he is too close to the CDU.

Wider Implications

¶18. (SBU) As a consequence of the Welteke scandal, Theodor Baums, law professor at the university of Frankfurt and financial market and corporate governance expert, was put in charge of corporate governance at the Bundesbank. He monitors compliance with the rules of conduct for the Bundesbank board, laid down in the Bundesbank law, the contracts relating to regional offices and branches, and the ethical code of the ECB. Baums' nomination is to ensure an "independent and objective external monitoring".

¶19. (SBU) Reportedly, the Finance Ministry insists on a clause in Weber's contract, referring to the strict rules of conduct for civil servants. As a consequence, changes may also need to be introduced in the contracts of the other Bundesbank board members.

¶20. (SBU) The recent events at the Bundesbank have raised public awareness of ethical conduct issues. Welteke's behavior may just be the tip of the iceberg - other similar cases are possible. The public outrage over the Welteke case may thus lead to the establishment of ethical rules or code of conduct in the Bundesbank or other institutions or, where they exist already, to stricter enforcement.

¶21. (SBU) Cleared with U.S. Embassy Berlin.

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